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SUBJECT: HR Issues in South China -- The New Labor Contract Law and Beyond

REF: Beijing 4467

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**¶11. (SBU) SUMMARY AND COMMENT:** Employers clearly emerged as "victors" in the labor contract law open comment vetting process, with the relaxation of several obligations that had been in the original draft, especially the requirement that they "seek approval from" their employees. Low-end manufacturers, in contrast, appear to have gained the least from the process, especially as it will require certain modifications in their organizational structure. The law should help clarify the rights of employees, and perhaps even curb somewhat the recent rise in labor disputes in South China. However, the region's greatest challenge remains the shortage of professionals in leadership positions. END SUMMARY AND COMMENT.

To the Employers Go the Spoils

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**¶12. (SBU)** Set to take effect in January 2008, the Labor Contract Law (LCL), published just a month ago, is the legislative product of almost three years of public engagement. The second major China law to have been forged out of a legitimate public comment process (the anti-money-laundering law is the other, though as yet not passed), the new LCL has been crafted with the support of comments from over 190,000 organizations and individuals, both from within China and abroad. While the final legislation makes numerous gestures toward improving workers' rights, employers have emerged as the clear beneficiaries from the public comment process according to Nancy Wu, Hewitt's Regional Consultant.

**¶13. (SBU)** Ms. Wu points to the relaxation of employer obligations between the initial and final drafts. For instance, the final LCL says employers should negotiate with -- instead of "seek approval from" -- the trade union or employees' representatives when making decisions that would directly affect the rights and interests of employees. Furthermore, while both drafts arguably limit the ability of employers to institute rule changes without first consulting the labor unions, the final draft significantly narrows the acceptable definition of "labor union." It therefore further limits the potential scenarios in which employers must actually consult with their labor counterparts.

Low-End Manufacturers Lose Out

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**¶14. (SBU)** Low-end manufacturers are among those who benefited least from the LCL's comment process. Zach Wortham, Legal Consultant for Wang Jing Law Firm in Guangzhou, attributes this to the overwhelming influence of Western foreign-invested enterprises on the final draft legislation. According to Wortham, since the LCL is in many ways a reflection of the worker protection provided to employees in Western

nations, Western FIEs will generally be able to borrow their home system as a comprehensive model, thus ensuring compliance under China's new LCL without the added costs of implementing an entirely new operational structure.

15. (SBU) Low-end manufacturers in industries such as textiles and apparel, on the other hand, will need to completely restructure their organizations in order to maintain compliance with the new LCL. The brunt of this is expected to fall on FIEs from neighboring South-East Asian countries, which typically control operations in these sectors.

#### It All Comes Down to Enforcement

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16. (SBU) Because of China's previous problems with enforcement, FIEs have raised concerns that the LCL may do little to change the ways of local companies, which often ignore inconvenient regulations, while simultaneously imposing an increased burden on already-compliant FIEs. (reftel)

17. (SBU) However, a surprising number of legal and business professionals in China's southern manufacturing region believe there are reasons for optimism. For one, many assert that since the current LCL is much clearer than any of China's previous labor laws, there will be less room for local interpretations. As such, local authorities will have less latitude in granting favorable exemptions to local companies. Some also believe that the comment process itself will lead to improvements in uniform enforcement. According to Dan Harris, Managing Partner for Harris & Moure PLLC, since the law was reached by consensus, local regulatory bodies should be expected to defer to its provisions, as opposed to previous laws which may have been more easily disregarded.

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#### Labor Disputes Increasing in South China

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18. (SBU) Employees in all industry sectors in the region appear to be stepping up their efforts for increased pay and benefits, whether against foreign-brand firms like KFC and McDonald's or Chinese companies; in addition, the number of labor tribunals has increased in every part of Guangzhou city. (NOTE: Due to their high caseload, these tribunals often operate in excess of fourteen hours per day. END NOTE.) Speaking anonymously, a representative of a major consulting firm in Guangzhou recently described a story in which their client, a multinational auto company, announced that it would be closing down its facility. The situation quickly escalated to a hostage takeover scenario between disgruntled employees and management. This is not uncommon in South China, particularly amidst the massive layoffs which sometimes follow large mergers and acquisitions. With the help of local government intervention, this particular situation was eventually resolved without bloodshed. The lesson, according to the consulting representative, is for FIEs to engage the government early in the negotiating process. This is especially evident in South China, where local government is often relatively accommodating to large multinational enterprises.

#### Qualified Professionals: The Drought in the South

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19. (SBU) According to Nancy Wu of Hewitt, at over 20 percent, China's professional personnel turnover rate currently leads all Asian countries. The problem has been further compounded by a local market of employers which so far has been either unwilling or unable to train talented personnel at an early stage of development. However, there are signs that companies in South China are beginning to take notice of the problem. More and more organizations appear to be engaging in benchmarking -- a process by which companies use multiple information sources to determine appropriate compensation. Ms Wu told us that some companies have even begun sharing pay data in order to manage costs and retain talent. In addition, an increasing number of local companies are beginning to realize the need to develop and promote talented individuals from within. If this trend continues, the region could remedy its current shortage

of experienced talent within five years.

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